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TAGS: ECON ENRG EINV
SUBJECT: LEGISLATION TO REFORM ECUADOR'S ELECTRICITY SECTOR
PRESENTED TO CONGRESS

REF: QUITO 1395

¶1. (SBU) Summary. President Palacio submitted to Congress July 10 legislation to reform Ecuador's electricity sector that would represent a significant advance if passed and implemented as proposed. The legislation would make it a crime to steal electricity, recognize almost $1 billion owed by the GOE to power distributors, and establish government payment guarantees for long term power purchase agreements (PPAs). U.S. companies would benefit directly from the acknowledgment of old debts and the ability to routinely offset debts to Petroecuador against money owed them by power distributors. Although not perfect, the proposed reform would address many of the industry's problems. However, given the repeated failure by Ecuador's Congress to approve similar legislation over the last two years, prospects for passage in this election year are slim. End Summary.

Current System Structurally Dysfunctional

¶2. (U) Ecuador's electricity sector is riddled with problems. The inability or disinterest of electricity distributors to bill and collect from consumers underlies a culture of non-payment that has created losses for most firms in the sector. Many consumers, both households and companies, steal power through clandestine connections. In addition, the GOE sets the price distributors can charge consumers below the price at which they purchase power. This "tariff deficit" creates a systematic loss on the distributors' books that they are legally unable to recover. Compounding this burden, Petroecuador sells subsidized fuel to power generators, thereby passing part of these losses onto the state oil company. Distributors pay generators via trust funds, and payment to each generator follows a pecking order that changes on political whims several times yearly. In practice, distributors have considerable discretion to assign funds. Trust funds focus exclusively on current month billing only, and any debt outstanding from prior months is disregarded entirely.

¶3. (U) Investment into the sector is minimal. Generators are unwilling to pour money into additional capacity when they are unpaid. Likewise, existing incentives paradoxically favor investment in high-cost, environmentally-unfriendly power generation because of fuel subsidies and transfer of accounts receivables to Petroecuador. The GOE also gives

preferential treatment to power generation in either Colombia or Peru, because Ecuador pays them 100% in advance to meet demand local generators cannot supply.

¶4. (SBU) Ecuadorian state entities, businesses and families benefit from this dysfunctional system, regularly not paying for electricity. GOE officials likely siphon off resources in the form of direct diversions of cash or commissions from those who receive contracts. State-owned companies control most of the distribution, with the exception of Guayaquil, which is served by a municipal-owned distributor, and six state-owned generators dominate the country's electricity generation (although private producers do generate energy at a much lower price). The cascading tradition of non-payment has technically bankrupted most state-owned companies involved. Should Ecuadorian businesses suddenly be forced to pay, the economic basis of many businesses in several industries would be directly threatened. In the end, the GOE pays as much as $1.5 billion annually, but the tangled web of contracts and legal constraints leaves the true cost difficult to define.

Electricity Sector Reform Legislation

¶5. (U) President Palacio submitted to Congress July 10 legislation to reform Ecuador's electricity sector that would represent a significant advance if passed and implemented as proposed. The bill was submitted as urgent and allows Congress only 30 days to revise and vote on it or it automatically becomes law. Legally, Congress must hold two debates and vote before August 6. The Economic Commission has committed to bringing the bill to the floor for the first debate by July 18.

¶6. (U) The most important piece of the reform is the GOE's guarantee to cover the tariff deficit and that it specifically recognizes an accumulated deficit of up to $950 million incurred between April 1, 1999 and December 31, 2005. The Ministry of Economy must calculate a revised deficit taking into account several complex rules outlined in the proposal within three months after the legislation is approved. It creates a Ministry of Economy fund to compensate distributors, which would open the door for more complete payment to electricity generators. However, the deficit guarantee is unlikely to cover all of the generators' outstanding debt.

¶7. (U) It also permits the Ministry of Economy to guarantee payment to power generators if the generator has participated in a public competition and entered into long-term power purchasing agreements (PPAs) to sell all of their production to Fondo de Solidaridad companies for at least five years, at a price below the predicted average annual market rate. (Comment: State-owned electricity and telephone companies belong to the Fondo de Solidaridad, a quasi-governmental holding company whose subsidiaries are exempt from government procurement rules. End comment.) In order to qualify for the guarantee, the purchasing distributor must be certified by the Central Bank and Ministry of Economy as "efficient". Payments based on this guarantee would be made directly to the company owed, without passing through the distributors' hands. The legislation officially recognizes the outstanding debt owed to generators for electricity provided but not paid for in prior years; however, it does not propose a method of paying this debt and prohibits the payment of accrued interest on these debts.

¶8. (U) The bill also requires a series of immediate steps to clean up and administer the Fondo's mismanaged accounts. The Fondo would be required to hire independent management, select board members and administrative personnel based on relevant qualifications, and define and implement a Code of Ethics. Finally, the bill would require Fondo power distributors to enter into PPAs for at least 75% of the power they purchase over the next five years.

¶9. (U) The legislation codifies the common practice of routinely offsetting outstanding payments with Petroecuador fuel purchases. Power generators that purchase fuel from Petroecuador and sell power to distributors will be able to routinely offset these accounts against one another, without the need for a special Presidential Decree each year.

¶10. (U) The bill allows the GOE to subsidize power consumers, but would require it to target specific social groups and the subsidy must be formally incorporated into the annual budget. Subsidies would be paid to the Fondo, who in turn must credit the subsidies directly to Fondo companies.

U.S. Firms in the Sector

¶11. (U) Two U.S. companies sell electricity to the state-owned power distributors, Machala Power (owned by Noble Energy) and Electroquil (Duke Energy); each is owed approximately $50 million to date and both have filed international arbitration proceedings to recover these losses. Machala, the largest U.S. investor after Oxy's expulsion, is a low-cost producer that has invested more than $370 million in a natural gas platform, processing plant, and an electricity generation plant (reftel). Eighty percent of the money owed to Machala is outstanding from previous months. Without a steady revenue stream, its headquarters in Texas is unwilling to invest an additional $125 million to double the plant's output. The company told us it is hopeful the bill passes to help guarantee payment, however the payment guarantee only for PPAs undercuts its attempts to sell electricity on the spot market. The interest payment exclusion also undermines Machala's international arbitration claim exceeding $200 million in interest and other damages.

¶12. (U) Duke Energy, in contrast, has benefited from the transfer agreement between distributors and Petroecuador, and passed off much of its outstanding payments to Petroecuador

in exchange for fuel. It has been a big proponent of codifying this exchange agreement into law and would benefit from the inclusion of the provision in the final law.

Comment

¶13. (SBU) Four attempts over the last two years to reform Ecuador's power sector have failed. While the proposed law is an imaginative step forward, it is unlikely to pass in its present form, or be implemented as intended. Indeed, congressional approval of such sweeping reforms in an election year is unlikely. Several Congressmen directly control local electricity distributors and electricity sector unions are extremely well organized, militant, and viscerally opposed to changing the status quo. Should the law pass as proposed, the Ministry of Economy would certainly pay some distributors, however the funds are unlikely to cover old debts to generators and non-payment by Fondo companies is likely to continue. The prospect of government guarantees could dramatically improve the performance of U.S. investments unless distributors collude to impose prices below generating cost. The value of government guarantees or of public recognition of debts is directly related to the price of oil and inversely to corruption in the sector. In the end, investment in Ecuador's electricity sector is unlikely to increase in any measurable way even under the best form of this legislation.
JEWELL